SCOTT N. SCHOOLS, S. Carolina Bar No. 9990
United States Attorney
THOMAS MOORE (ASB 4305-078T)
Assistant United States Attorney
Chief, Tax Division
9th Floor Federal Building
450 Golden Gate Avenue, Box 36055
San Francisco, CA 94102
Tel. No. (415) 436-7017
Fax No. (415) 436-6748

THOMAS M. ROHALL, Wash. St. Bar No. 12201
Special Assistant United States Attorney
4330 Watt Ave., Suite 470
Stop No. SA 2801
Sacramento, CA 95821-7012
Tel. No. (916) 974-5700
Fax No. (916) 974-5732
Attorneys for United States of America

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

OAKLAND DIVISION

In re: DEAN GORDON POTTER, Debtor,	Civil No. C 07-CV-04826 CW Bankr. No. 06-42425-LT-11 **UNITED STATES' REPLY TO OPPOSITION TO MOTION TO WITHDRAW REFERENCE and TO TRANSFER VENUE**

The United States of America, through undersigned counsel, hereby replies to "Dean Gordon Potter's, Debtor, Opposition to the United States of America's Motion to Withdraw Reference and to Transfer Venue" ("Opposition").[1] The District Court has referred this motion to the Bankruptcy Court for recommendations.

[1] The debtor's Opposition was captioned with an incorrect case number.

The United States filed this motion for mandatory withdrawal of this Court's reference of debtor Dean Gordon Potter's federal tax dispute[2] to the United States Bankruptcy Court for the Northern District of California. The United States further requested that the Court transfer the entire tax proceeding to the Eastern District of California, where a closely related federal tax refund suit is currently pending, *Unico Services Inc. v. United States*, no. 2:07-CV-01009-MCE-KJM (E.D. Cal.). The goal of this motion is to consolidate the Potter and Unico matters, which are intertwined and arise from the same transactions, for discovery and trial. All of the tax issues stem from an offshore employee leasing arrangement (the "OEL Arrangement") engaged in by Potter and Unico.[3]

The debtor's Opposition, filed September 26, 2007, in the District Court case, makes three arguments: (1) the motion to withdraw the reference was not timely, (2) withdrawal is not appropriate, and (3) transfer of venue is not required. The arguments of the debtor lack merit as discussed below.

1. **The Motion to Withdraw the Reference Was Timely.**

The debtor argues that the United States has been aware of the tax issues since the Potter bankruptcy case was filed, some nine months before the motion to withdraw the reference. The United States agrees that a motion to withdraw the reference must be filed timely under the circumstances of each case, but disagrees as to when the clock begins ticking.

The goal of this motion is to bring together two cases filed which concern the same transactions. The United States filed this motion on September 7, 2007, a total of three weeks after its timely-filed Answer in the Unico corporate employment tax refund case, which concerns only Potter's earnings. The United States submits that the promptness of the motion

---

[2] The Potter federal tax dispute includes an adversary proceeding for tax refund and the debtor's objection to the IRS claim. The United States does not seek to withdraw the reference as to the entire bankruptcy case.

[3] Only a bare outline of the full circular transaction was presented in this motion. The portion where Potter makes transfers offshore to Namur, which eventually takes ownership of the money held offshore through Pixley or IESI, deserves mention.

should be measured from the time it was required to respond in the Unico matter. Rule 12 of the Federal Rules of Civil Procedure provides the United States with sixty days to respond to a complaint, in recognition of the agency coordination that must occur before a good faith response can be filed by the United States. To insist that the motion to withdraw must be filed before the answer was due would cut short the response time provided by the federal rules.

"There is no specific time limit for applications under 28 U.S.C. § 157(d) to withdraw a reference to the bankruptcy court ...." *Lone Star Indus. v. Rankin County Economic Dev. Dist. (In re New York Trap Rock Corp.)*, 158 B.R. 574, 577 (S.D.N.Y.1993). However, the language of 28 U.S.C. § 157(d) requires that there be a "proceeding" to withdraw, i.e. a contested matter or an adversary proceeding between the debtor and a creditor. *In re CM Holdings*, 221 B.R. 715, 720 (D. Del. 1998). The debtor argues that the timeliness of the motion to withdraw should be measured from the filing of the bankruptcy petition. This ignores the language in 28 U.S.C. § 157(d) which requires a contested matter or adversary proceeding.

CASE	TYPE OF CASE	WHEN FILED	ACTION	LOCATION
In re Potter, No. 06-42425-11-LT	Chapter 11 bankruptcy case	12/12/06	06/06/07 IRS Claim Filed	Oakland Bankr. Court
Potter v. U.S. No. 07-04066-LT	Tax refund Adversary Proc. for the 1998 year	04/09/07	8/22/07 US Answer filed	Oakland Bankr. Court
Unico v. U.S. No. 02-07-01009 MCE	Tax refund case for tax on Potter payroll	05/29/07	8/17/07 US Answer filed	Sacramento District Court
In re Potter, No. 06-42425-11-LT	Objection to IRS proof of claim	06/28/07		Oakland Bankr. Court
In re Potter, No. 4-07-CV-074826 CW	Motion to Withdraw Reference	09/07/07		Oakland Bankr. Court

The Court should note, as set forth in the table above, that the initial filing of an adversary proceeding to seek a tax refund for one year was filed by the debtor **before** any

proof of claim was filed by the Internal Revenue Service. This adversary pertained to a small portion of the many years later at issue in the Service's proof of claim. To count the time from this adversary proceeding would essentially allow the debtor to accelerate the response time of the United States, and would make multiple motions necessary as the true extent of the case became evident.

In one case, a debtor argued that the dispute was at issue from the time the IRS filed its proof of claim, some ten months before the motion to withdraw. However, the court determined that timeliness of a motion to withdraw a reference is governed from the point of time when the debtor filed its objection, not when the IRS first filed its proof of claim. *In re CM Holdings*, 221 B.R. 715, 720 (D. Del. 1998). Measured from debtor's objection in Potter, the United States filed its motion within two months, less time allowed to respond. This response time is reasonable in this case, considering the complexity of this matter. *See, e.g.*, *In re The VWE Group, Inc.*, 359 B.R. 441 (S.D. N.Y. 2007) (holding timely a motion to withdraw filed four and one-half months after an adversary proceeding).

Cases which hold periods less than five months as untimely are largely predicated on tactical delay and forum shopping, neither of which is present here. *In re The VWE Group, Inc.*, 359 B.R. at 447. The United States does not seek to forum shop in this case, as it is equally content with the District Court of the Northern District or the Eastern District of California. In the Bankruptcy Court, however, there is no possibility that the Unico trial, which will require adjudication of the same facts, could be consolidated with the bankruptcy trial, since the debtor is not a party. Furthermore, this case concerns a tax shelter which has not been litigated and such trials often require five weeks of continuous trial time. Continuous trial time would be absolutely essential in order to unwind the deliberately complicated offshore scheme. In the experience of the counsel for the United States, the Bankruptcy Court docket does not permit such continuous trial time, which is routinely available in District Court.

Unico, an entity controlled by Potter, created the potentially conflicting, double-trial problem by filing its tax refund suit in Sacramento and serving its complaint on the United States in June of 2007. In August of 2007, the United States filed its timely answer in the

Unico case, and three weeks later filed this motion to seek to consolidate this tax dispute in a suitable jurisdiction. Filing a motion to withdraw the reference within three weeks is certainly timely. Even if the two-month period from the filing of the debtor's objection to claim is considered, it should be considered timely, particularly where a complex tax matter is at issue. The timing of the motion has not prejudiced the debtor and has not interfered with the administration of the bankruptcy estate. As a practical matter, all the related actions are in their preliminary stages, with minimal to no discovery completed. The Court should recommend that this motion was filed in a timely manner in these circumstances.

2. **Withdrawal of the Reference is Appropriate Here.**

The debtor argues that this case involves familiar tax doctrines of "substance over form," "step-transaction" and "economic substance." Although debtor describes these as "factual" doctrines, they are judicially-created doctrines.

> The economic substance doctrine represents a judicial effort to enforce the statutory purpose of the tax code. From its inception, the economic substance doctrine has been used to prevent taxpayers from subverting the legislative purpose of the tax code by engaging in transactions that are fictitious or lack economic reality simply to reap a tax benefit. In this regard, the economic substance doctrine is not unlike other canons of construction that are employed in circumstances where the literal terms of a statute can undermine the ultimate purpose of the statute.

Coltec Industries, Inc. v. United States, 454 F.3d 1340, 1353 (Fed. Cir. 2006) (rejecting Constitutional challenge to economic substance doctrine.)[4]

The debtor attempts to distinguish the cases cited in support of this motion by noting that they required specialized or novel interpretations of non-bankruptcy law. The debtor describes this as "not a case of first impression." (Opposition, 10, ¶ ii) However, the debtor then **concedes** that this is a case of first impression: "It may be the first case to determine whether these factual doctrines apply to the case at issue involving the establishment of a foreign non-qualified deferred compensation plan." (*Id.*) The debtor fails to provide any case

[4] We do not suggest that Potter and Unico were strictly in compliance with the Internal Revenue Code. Blatant violations did exist in the OEL Arrangement. For example, payments for non-qualified deferred compensation are not currently deductible by the corporation. I.R.C. § 404. But Unico did deduct the purported non-qualified deferred compensation. Furthermore, the compensation was not deferred because Potter retained control of it.

authority showing that the legality of the offshore employee leasing arrangement has been adjudicated.

It is true that the Service has "listed" the transaction as being subject to challenge, but this does not resolve the issues in this case. IRS Notice 2003-22, 2003-18 I.R.B. 851, 1 C.B. 851 (IRB 2003). As a result of the listing, taxpayers may need to disclose their participation in this transaction as prescribed in Treas. Reg. § 1.6011-4, and promoters (or other persons responsible for registering tax shelter transactions) may need to register these transactions under Treas. Reg. § 301.6111-2. However, "[t]he fact that a transaction is a reportable transaction shall not affect the legal determination of whether the taxpayer's treatment of the transaction is proper." Treas. Reg. § 1.6011-4(a). This case is one of first impression involving the application of judicial doctrines to a very complex arrangement which was intended to circumvent the requirements of the Internal Revenue Code. The Court should recommend that the District Court withdraw the reference here.

The debtor's claim that this is a simple case is disingenuous. This matter is no less difficult and significant than the disputes in *CM Holdings* and *G-I Holdings*. *In re CM Holdings, Inc.*, 221 B.R. 715, 721 (D. Del. 1998); *In re G-I Holdings, Inc.*, 295 B.R. 222 (D. N.J. 2003). Both involved complex tax matters and are the cases most on point in this motion. *CM Holdings* concerned corporate-owned life insurance, in which premium payments on 1,400 employees were deducted, although the premiums were funded by loans on the policies. This represented an attempt to dodge restrictions on the deductibility of interest on loans on life insurance. In *G-I Holdings* a sale was disguised as a partnership formation in an attempt to dodge capital gains tax on the profit on the sale. Like those cases, this case will require the Court to recharacterize transactions to reflect their substance and to avoid subversion of the Internal Revenue Code. Tax shelter cases have significance beyond the individual debtor and should always be considered for withdrawal of the reference.

3. **The Potter and Unico cases should be consolidated**.

The debtor in his Opposition admits that Potter's tax issues arose from the Unico audit but argues that venue should not be transferred to permit consolidation. The debtor claims that

different issues and different facts are at issue in the two cases. The debtor further argues that only the limited issue of unpaid employment tax (on Potter's income) is at issue in Unico. The debtor's assertions lack merit because all the issues in both cases arise directly from the same facts, and should be tried in one proceeding.

The Court in Unico must determine (among other things) whether amounts held offshore (purportedly non-qualified deferred compensation) were **currently taxable to Potter**, and so subject to employment tax withholding at the corporate level. The Court in Potter must determine whether the same payments were **currently taxable to Potter**, to determine whether additional individual income tax is due, as claimed on the IRS proof of claim. If the cases are not consolidated, it is possible the two courts will answer this question differently. On the same payments, Unico claimed deductions against its taxable income. This belies the debtor's argument that the payments are non-qualified deferred compensation, because such payments are not currently deductible. I.R.C. § 404. The United States is considering a counterclaim against Unico, so that all tax liabilities of Unico arising from this OEL Arrangement can be determined in one proceeding. The debtor is not accurate in describing the issues in Unico as narrow and limited; they are complex, significant, and intertwined.

CONCLUSION

Unico and Potter began, but did not finish, litigating portions of these tax liabilities in the Tax Court and the Court of Federal Claims. With cases in the Bankruptcy and District Courts, Potter and Unico have now exhausted the list of possible federal judicial forums in the United States. The attempt at piecemeal litigation is a further effort to obscure the substance of the intentionally complicated scheme at issue here. The complexity and the use of tax havens in the OEL Arrangement are further attempts to conceal the truth of this transaction, which at its heart is merely the failure to report taxable income. This Court should recommend the withdrawal of the reference as to the Potter tax disputes and the transfer of venue under 28 U.S.C. § 1412 to the Eastern District of California, so that the complete tax shelter can be reviewed in one proceeding.

The United States would appreciate the opportunity to present oral argument on this motion, if the Court would consider it helpful.

SCOTT N. SCHOOLS,
United States Attorney

Dated: October 11, 2007

/s/ Thomas Moore
THOMAS MOORE
Assistant United States Attorney
Chief, Tax Division
9th Floor Federal Building
450 Golden Gate Avenue, Box 36055
San Francisco, CA 94102
Tel. No. (415) 436-7017

CERTIFICATE OF SERVICE

I, **KATHY TAT** declare:

That I am a citizen of the United States of America and employed in San Francisco County, California; that my business address is Office of United States Attorney, 450 Golden Gate Avenue, Box 36055, San Francisco, California 94102; that I am over the age of eighteen years, and am not a party to the above-entitled action.

I am employed by the United States Attorney for the Northern District of California and discretion to be competent to serve papers. The undersigned further certifies that I caused a copy of the following:

UNITED STATES' REPLY TO OPPOSITION TO MOTION TO WITHDRAW REFERENCE and TO TRANSFER VENUE

to be served this date upon the party(ies) in this action by placing a true copy thereof in a sealed envelope, and served as follows:

_X___ **FIRST CLASS MAIL** by placing such envelope(s) with postage thereon fully prepaid in the designated area for outgoing U.S. mail in accordance with this office's practice.

____ **PERSONAL SERVICE (BY MESSENGER/HAND DELIVERED)**

____ **FACSIMILE (FAX)** No.: _____

to the parties addressed as follows:

John Gigounas
100 Pine Street, Suite 750
San Francisco, CA 94111

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

Executed on **October 11, 2007** at San Francisco, California.

/s/ Kathy Tat
KATHY TAT
Legal Assistant